No. 04-1264

IN THE

Supreme Court of the United States

BUCKEYE CHECK CASHING, INC.,
Petitioner,

v.

JOHN CARDEGNA AND DONNA REUTER,
Respondents.

On Writ of Certiorari
to the Supreme Court of Florida

BRIEF OF AMICUS CURIAE THEIS RESEARCH, INC., IN SUPPORT OF NO PARTY ON THE MERITS

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INTRODUCTION

Congress never intended the Federal Arbitration Act to be a Trojan horse to assault the citadel of police powers vested in the states. The FAA is not a general federal license—and enforcement mechanism—for private parties to contract in violation of state law. The FAA does not authorize unlawful conduct, even if one enlists an arbitrator as an accessory after the fact.

The FAA does not authorize courts to confirm arbitration awards that derive from unlawful contracts. Instead, 9 U.S.C. § 2 requires that courts uphold and enforce law applicable to contracts generally, and 9 U.S.C. § 10 requires that courts vacate awards issued by arbitrators who act without power conferred by a valid contract.

INTERESTS OF THE AMICUS CURIAE[1]

Amicus curiae Theis Research, Inc. (Theis, pronounced "Tice") is the petitioner in *Theis Research, Inc. v. Brown & Bain*, No. 04-1566. The petition for a writ of certiorari in that case is pending before the Court as of the submission of this brief.

The law firm of Brown & Bain (B&B, respondent in No. 04-1566) previously represented Theis in patent litigation that went awry. The representation primarily

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[1] This brief is submitted pursuant to the general consent to the filing of amicus briefs, filed by each party on August 1, 2005. This brief has not been authored, in whole or in part, by counsel for a party in this case (No. 04-1264). No monetary contribution to its preparation or submission has been made by any person or entity other than Theis Research, Inc., its counsel, and Success at Last LLC, a non-equity investor in Theis.

involved litigation in the Northern District of California. B&B's legal services agreement provided that it was governed by California law.

To comply with an arbitration clause in B&B's legal services agreement, Theis arbitrated its malpractice claims against B&B. The arbitrator's award gave nothing to either side. Theis thereafter discovered that B&B had violated state conflict-of-interest law because it had simultaneously represented the integrated subsidiary of an adverse party in the patent litigation. By undertaking to represent Theis, B&B had violated California law.[2]

Theis filed a diversity action in the United States District Court for the Northern District of California, seeking to vacate the arbitration award. Theis relied on California law holding unlawful contracts void *ab initio* and nullifying embedded arbitration clauses and resulting awards. Theis cited additional conflicts disclosed in discovery. The district court nevertheless confirmed the arbitration award and held that Theis' conflict of interest claims were barred by claim preclusion doctrine. On appeal, the Ninth Circuit affirmed.

The issues presented by Theis' petition for a writ of certiorari include the following related questions:

- Whether courts—as opposed to arbitrators—shall decide challenges to an underlying agreement with an arbitration clause on the ground that the agreement was void and never existed at the outset, in contrast to agreements that are merely voidable.

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[2] B&B concurrently violated a district court rule incorporating the California Rules of Professional Conduct. *See* U.S. District Court, N.D. Cal., Civil Local Rule 11-4.

- Whether, in a diversity case, state law can render an unlawful underlying agreement, including an arbitration clause and a resulting arbitration award, null and void *ab initio*.

Because the Court has determined that the Federal Arbitration Act applies to state court proceedings (*Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984)), the rule applicable to diversity cases would also govern state court cases, such as the present case.

Theis generally supports the position of respondents in this case.

However, Theis also raises considerations that do not appear to advance respondents' position. Theis discusses below the approach that has been taken by the California courts, which distinguishes unlawfulness of the underlying contract as a whole versus unlawfulness of a single, severable provision.

In *Theis Research, Inc. v. Brown & Bain*, where B&B's attempted formation of a legal services agreement with Theis was unlawful *per se*, the illegality applies to the purported contract as a whole. In such circumstances, the California courts have held that the entire agreement—including any arbitration clause—is void *ab initio*.[3] Because there was never any valid underlying agreement, there is no effective arbitration clause, and no authority is contractually conferred on an arbitrator. Without authority, any determination by an arbitrator is a nullity, and any arbitration award must be vacated.

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[3] California authorities refer interchangeably to illegality and unlawfulness.

On the other hand, the California courts have held that illegality of a single provision, if severable, does not void a remaining lawful agreement. In that instance, the arbitration clause survives with the remainder of the contract; the parties' dispute is arbitrable; and even the illegality challenge to the single provision must be presented to the arbitrator—at least in the first instance.

Theis also addresses the role of courts in ruling on questions of illegality on post-arbitration review. The instant case comes before the Court pre-arbitration. The trial court denied petitioner's motion to compel arbitration and to stay judicial proceedings. Nevertheless, as discussed below, petitioner noted in its brief to the Florida Supreme Court the role of courts in addressing illegality in proceedings to enforce an arbitrator's award.

Theis has argued in support of its petition for a writ of certiorari that plenary review of *Theis Research, Inc. v. Brown & Bain* should be joined with consideration of this case to frame the complete picture of the matter at issue. Pending the Court's consideration of that request, Theis respectfully offers the arguments set forth below.

STATUTES INVOLVED

9 U.S.C. § 2. *Validity, irrevocability, and enforcement of agreements to arbitrate*

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3. *Stay of proceedings where issue therein referable to arbitration*

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 4. *Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination*

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement . . . be in issue, the court shall proceed summarily to the trial thereof. . . . Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, . . . demand a jury trial of such issue, ...

9 U.S.C. § 9. *Award of arbitrators; confirmation; jurisdiction; procedure*

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, . . . any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. . . .

9 U.S.C. § 10. *Same; vacation; grounds; rehearing*

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) where the award was procured by corruption, fraud, or undue means;

* * *

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

* * *

SUMMARY OF ARGUMENT

Under the Federal Arbitration Act (FAA), the authority of an arbitrator pursuant to an arbitration clause embedded in a contract is premised on the validity of the underlying contract under state law applicable to contracts generally. There is no basis for submitting a matter to an arbitrator if illegality rendered the underlying contract void *ab initio*.

Accordingly, whether the underlying agreement is valid or void *ab initio* is a gateway issue that must be decided by a court. The fraud-in-the-inducement rule of *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), does not require a different result. That rule

presupposes the existence of a valid agreement, subject only to voidability and subsequent rescission at the option of a defrauded party.

While a court must determine a challenge based on unlawfulness that pertains to the underlying agreement as a whole, an illegality challenge could be submitted to an arbitrator in the first instance if it only concerns a single, severable provision and would not have the effect of voiding the remainder of the underlying contract (which includes the surviving arbitration clause).

Particularly on post-arbitration review, courts must decide illegality challenges if the FAA is not to be transmuted into a tool for the judicial enforcement of private contracts entered into in violation of generally applicable state law.

ARGUMENT

I. An underlying contract valid under state law is a precondition for an embedded arbitration clause to be effective under the Federal Arbitration Act

It takes a valid contract to have a valid contract with an arbitration clause.

The Federal Arbitration Act (FAA) conditions the effectiveness of an arbitration clause on compliance with law applicable to contracts generally. At 9 U.S.C. § 2, the FAA provides that an arbitration clause

> shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

State-law contract rules govern the validity of arbitration agreements. Although Congress enacted the FAA pre-*Erie*, the Court has effectuated principles of federalism in the application of § 2.

> When deciding whether the parties agreed to arbitrate a certain matter . . ., courts generally . . . should apply ordinary state-law principles that govern the formation of contracts.

First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995).

In *Prima Paint*, the Court noted that when enacting the FAA, Congress intended "to make arbitration agreements as enforceable as other contracts, but not more so." 388 U.S. at 404 n.12.

Interpreting § 2, the Court has applied this neutrality test in determining whether state law renders a purported arbitration clause invalid.

> States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added).

Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995); *accord Doctor's Associates v. Casarotto*, 517 U.S. 681, 686-687 (1996).

Under the FAA, the application by courts of "ordinary state-law principles that govern the formation of contracts"